

**Financial Statements**

39	Consolidated Income statement
40	Consolidated Balance-sheet
41	Statement of cash flows
42	Statement of Changes in Equity
44	Basis of Accounting Policies
44	Consolidated companies
46	Principals of consolidation
47	Currency translation
48	Estimates and assumptions
49	Accounting Policies
55	Comments to the profit and loss statement
61	Comments to the consolidated Balance-sheet
73	Notes to the Cash Flow Statement
76	Notes to the Segment report
80	First-time application of IFRS
89	Other disclosures

## Consolidated Income statement for the twelve months ended December 31, 2004

€ thousands	Note	2004	2003
Licenses		114,214	104,280
Maintenance		182,565	191,236
Services		112,828	122,871
Other		1,764	1,655
<b>Total revenue</b>	[1]	<b>411,371</b>	<b>420,042</b>
Cost of sales	[2]	- 137,402	- 151,733
<b>Gross profit</b>		<b>273,969</b>	<b>268,309</b>
Research and development	[3]	- 49,004	- 61,833
Sales, marketing and distribution	[4]	- 89,095	- 99,370
Administrative costs	[5]	- 45,298	- 55,074
<b>Operating result</b>		<b>90,572</b>	<b>52,032</b>
Income from sale of SAP-SI shares	[6]	24,539	0
Other operating income	[7]	13,557	17,795
Other operating expenses	[8]	- 18,310	- 10,760
Restructuring expenses		0	- 48,792
<b>Earnings before interest, taxes and amortization</b>		<b>110,358</b>	<b>10,275</b>
Amortization	[9]	- 1,881	0
<b>Earnings before interest and taxes</b>		<b>108,477</b>	<b>10,275</b>
Interest result	[10]	3,253	2,748
<b>Earnings before taxes</b>		<b>111,730</b>	<b>13,023</b>
Income taxes	[11]	- 33,049	- 4,201
Other taxes	[12]	- 1,442	- 1,759
<b>Consolidated income</b>		<b>77,239</b>	<b>7,063</b>
Thereof for shareholders of Software AG		77,125	7,096
Thereof for minority interest	[13]	114	- 33
Earnings per share (EUR, basic)	[14]	2,83	0,26
Earnings per share (EUR, diluted)	[14]	2,83	0,26
Weighted average shares outstanding (basic)		27,266,752	27,266,752
Weighted average shares outstanding (diluted)		27,266,752	27,266,752

<b>Consolidated Balance-sheet</b>			
<b>Assets</b>			
<b>€ thousands</b>	<b>Note</b>	<b>December 31, 2004</b>	<b>December 31, 2003</b>
<b>Current assets</b>			
Cash on hand and bank balances	[15]	89,397	53,083
Securities	[15]	29,695	21,076
Inventories		345	387
Trade receivables	[16]	109,674	108,993
Other receivables and other assets	[17]	4,015	7,701
Deferred expense	[18]	5,261	6,476
		<b>238,387</b>	<b>197,716</b>
<b>Non-current assets</b>			
Intangible assets	[19]	1,516	1,491
Goodwill	[20]	174,591	176,472
Property, plant and equipment	[21]	44,274	47,880
Financial assets	[22]	1,592	21,539
Trade receivables	[16]	14,648	15,585
Deferred taxes	[23]	35,677	44,959
		<b>272,298</b>	<b>307,926</b>
		<b>510,685</b>	<b>505,642</b>
<b>Equity and liabilities</b>			
<b>€ thousands</b>	<b>Anhang</b>	<b>31. 12. 2004</b>	<b>31. 12. 2003</b>
<b>Current liabilities</b>			
Financial liabilities	[24]	3,349	6,546
Trade liabilities	[25]	21,192	26,770
Other liabilities	[26]	22,279	25,294
Other provisions	[27]	33,257	66,145
Tax provisions	[29]	14,291	10,929
Deferred income	[30]	47,245	57,330
		<b>141,613</b>	<b>193,014</b>
<b>Non-current liabilities</b>			
Financial liabilities	[24]	3,490	4,356
Trade payables		0	22
Other liabilities		299	1,108
Provision for pensions	[28]	22,149	19,666
Other provisions	[27]	906	5,357
Deferred taxes	[23]	12,443	12,798
Deferred income	[30]	6,183	0
		<b>45,470</b>	<b>43,307</b>
<b>Equity</b>			
Share capital	[31]	81,800	81,800
Capital reserve		132	132
Retained earnings		154,032	149,358
Consolidated income		77,125	7,096
Currency translation differences		- 41,574	- 32,340
Other reserves	[32]	51,847	63,149
Minority interest	[33]	240	126
		<b>323,602</b>	<b>269,321</b>
		<b>510,685</b>	<b>505,642</b>

Statement of cash flows for the twelve months ended			
Dezember 31, 2004			
€ thousands	Anhang	2004	2003
	[34]		
Consolidated net income		77,239	7,063
Income taxes		33,049	4,201
Interest result		- 3,253	- 2,748
Depreciation		11,152	10,753
Income from sale of SAP-SI shares		- 24,539	0
Income from sale of other assets		288	399
<b>Cash generated from operations</b>		<b>93,936</b>	<b>19,668</b>
Changes in inventories, receivables and other current assets		3,753	5,986
Changes in payables and other liabilities		- 48,907	14,845
Income taxes paid		- 22,920	- 29,725
Interest paid		- 2,360	- 1,223
Interest received		5,353	3,959
<b>Net cash provided by operating activities</b>		<b>28,855</b>	<b>13,510</b>
Cash received from the sale of tangible/ intangible assets		166	1,316
Investments in tangible/ intangible assets		- 6,031	- 6,329
Cash received from the sale of financial assets		27,371	280
Investments in financial assets		- 846	- 1,292
<b>Net cash provided by/used in investing activities</b>		<b>20,660</b>	<b>- 6,025</b>
Proceeds from issues of minority share capital		0	159
Repayment of loans from acquisitions and other finance liabilities		- 3,170	- 5,533
<b>Net cash used in financing activities</b>		<b>- 3,170</b>	<b>- 5,374</b>
<b>Change in cash funds from cash relevant transactions</b>		<b>46,345</b>	<b>2,111</b>
<b>Adjustment from currency translation</b>		<b>- 1,412</b>	<b>- 3,375</b>
<b>Net change in cash and cash equivalents</b>		<b>44,933</b>	<b>- 1,264</b>
Cash and cash equivalents at the beginning of the period		74,159	75,423
<b>Cash and cash equivalents at the end of the period</b>		<b>119,092</b>	<b>74,159</b>

Statement of Changes in Equity					
€ thousands	Note	Shares Number	Share capital	Capital reserve	Retained earnings
<b>Equity as of January 1, 2003</b>		27,266,752	81,800	132	149,358
Consolidated income of the period					
Change in consolidation group					
Currency translation differences					
Net gains from the fair value valuation of securities not recognized in income statement					
Net gains from the fair value valuation of loans with group members not recognized in income statement					
<b>Equity as of December 31, 2003</b>		27,266,752	81,800	132	149,358
<b>Equity as of January 1, 2004</b>		27,266,752	81,800	132	156,454
Consolidated income of the period					
Currency translation differences					
Net gains from the fair value valuation of securities not recognized in income statement	[35]				
Net gains from the fair value valuation of loans with group members not recognized in income statement					
Net loss from actuarial gain/loss not recognized in income statement					- 2,422
<b>Equity as of December 31, 2004</b>		27,266,752	81,800	132	154,032

Consolidated income	Currency translation differences	Other reserves	Minority interest	Total
0	0	27,639	0	258,929
7,096			- 33	7,063
			159	159
	- 32,340			- 32,340
		8,593		8,593
		26,917		26,917
7,096	- 32,340	63,149	126	269,321
0	- 32,340	63,149	126	269,321
77,125			114	77,239
	- 9,234			- 9,234
		- 17,345		- 17,345
		6,043		6,043
				- 2,422
77,125	- 41,574	51,847	240	323,602

## Summary of significant accounting policies

### Basis of presentation

In fiscal 2004, Software AG's consolidated financial statements were for the first time prepared in accordance with the International Financial Reporting Standards ("IFRS") as promulgated by the International Accounting Standards Board (IASB). The IFRS/IAS applicable as of December 31, 2004, were observed, as were the corresponding interpretations of the International Financial Reporting Interpretations Committee (IFRIC, formerly SIC). In addition, the following standards have been adopted, despite the fact that their application is not yet mandatory: IAS 1, (revised 2003), IAS 36, (revised 2004), IAS 38, (revised 2004), IFRS 3 and IAS 19 (revised in December 2004), and IFRS 2.

Significant differences between IFRS and German accounting in accordance with the provisions of the German Commercial Code ("HGB") include the measurement of goodwill, provisions, and provisions for employee benefits, as well as the classification of leases, recognition of income from long-term

service contracts according to percentage of completion, and accounting for deferred tax assets and liabilities.

Software AG is a publicly quoted corporation established under German law registered in Darmstadt. The Company is active worldwide in the fields of software development, software licensing, software maintenance and IT services.

The consolidated financial statements of Software AG are expressed in thousands of euro unless otherwise stated.

### Scope of consolidation

The consolidated financial statements include Software AG and all companies it controls. Control is generally considered to exist, if Software AG directly or indirectly controls the majority of voting rights of a company's share capital and/or is in a position to determine the financial and operating policies of a company.

The following affiliated companies belong to the Software AG Group, of which the latter is the parent.

a) Domestic companies		
	Share in %	Company code
Software GmbH Marketing, Darmstadt	100	SAG-MK
SAG East GmbH, A Software Company, Darmstadt	100	SAG-ME
SQL Datenbanksysteme GmbH, Berlin	100	SQL
SAG Systemhaus GmbH, Darmstadt	100	SAG-D

b) Foreign companies		
	Share in %	Company code
Software AG (UK) Limited, Derby/UK	100	SAG-UK
with its subsidiary:		
Software AG Belgium S.A., Brussels/Belgium,	100	SAG-B
In which Software AG also has a direct stake		
Software AG France S.A.S, Ivry sur Seine/France	100	SAG-F
Software AG Italia S.p.A, Cassina de' Pecchi (MI)/Italy	100	SAG-I
Software AG Nederland B.V., Nieuwegein/The Netherlands	100	SAG-NL
with its subsidiary:		
Software AG Management Services B.V., Nieuwegein/The Netherlands	100	SAG-MS
and an indirect stake in:		
IC-Group B.V., Nieuwegein/The Netherlands	100	IC-Group
Software AG Nordic A/S, Taastrup/Denmark	100	SAG-DK
with its subsidiaries:		
Software AG Norge A/S, Oslo/Norway	100	SAG-N
Software AG Sverige AB, Stockholm/Sweden	100	SAG-S
OY Software AG Finland, Helsinki/Finland	100	SAG-SF
Software AG Österreich, Wien/Austria	100	SAG-A
Software AG Polska Sp. z o.o., Warszawa/Poland	100	SAG-PL
Software AG s.r.o., Praha/The Czech Republic	100	SAG-CS
Software AG Bilgi Sistemleri Ticaret A.S., Istanbul/Turkey	100	SAG-TR
Softinterest Holding AG, Zug/Switzerland	100	SIH
with its subsidiary:		
SAG Software Systems AG, Dietikon/Switzerland	100	SAG-CH
Software AG España S.A., Unipersonal, Tres Cantos, (Madrid)/Spain	100	SAG-E
and an indirect stake in:		
Software AG España Systemhaus, S.L., Unipersonal, Tres Cantos (Madrid)/Spain	100	SAG-ESYS
Software AG Portugal, Alta Tecnologia Informática, Lda., Lisboa/Portugal	100	SAG-P
Software AG, Inc., Reston, VA/USA	100	SAG-USA
with its subsidiaries:		SAG-USA-Gruppe
Software AG, LLC, Reston, VA/USA	100	
and an indirect stake in:		
Software AG Australia (Holdings) Pty. Ltd., North Sydney/Australia	100	SAG-AUS (Holding)
with its subsidiary:		
Software AG Australia Pty. Ltd., North Sydney/Australia	100	SAG-AUS
Software AG Funding Corp., Reston, VA/USA	100	
Software AG International, Inc., Reston, VA/USA	100	
Software AG (Canada), Inc., Ontario/Canada	100	
Software AG, S.A. de C.V. Lomas de Chapultepec/Mexico D.F./Mexico	100	
SGML Technologies Ltd., Derby/UK	100	SGML-UK
Software AG R&D Ireland, Ltd., Wicklow-Town/Ireland	100	SAG-IRL
Software AG (Hong Kong) Ltd., Hong Kong/The People's Republic of China	100	SAG-HK
Software AG (Singapore) Pte. Ltd., Singapore/Singapore	100	SAG-SIN
with its subsidiary:		
Software AG (Asia Pacific) Support Centre Pte. Ltd., Singapore/Singapore	100	SAG-AP
Software AG (M) Sdn. Bhd., Kuala Lumpur/Malaysia	100	SAG-MAL
Software AG (Philippines) Inc., Pasig City/The Philippines	100	SAG-PHI
Software AG (Taiwan) Ltd., Taipei/Taiwan	100	SAG-TW
Software AG South Africa (Pty.) Ltd., Bryanston/ South Africa	100	SAG-ZA
Software AG (India) Pvt. Ltd., Pune/India	51	SAG-IN

The scope of consolidation has changed in comparison to December 31, 2003, due to the initial consolidation of the company Software AG España, Systemhaus S.L., Unipersonal, Madrid, Spain. We established this company on May 13, 2004, with subscribed capital of €60,000 and consolidated it at the same point in time. There were no further changes in the scope of consolidation compared to December 31, 2003.

With the approval of the respective shareholders' meetings, consolidated Group companies SAG Systemhaus GmbH, Darmstadt, SAG East GmbH, Darmstadt, and SQL Datenbanksysteme GmbH, Berlin, exercised the option provided in Section 264, paragraph 3, no. 4 of the HGB and are thus exempt from the duty to prepare and publish additional financial statements in accordance with HGB accounting.

### **Principles of consolidation**

The separate financial statements of the companies included in the consolidated financial statements were prepared according to uniform accounting policies in accordance with IFRS as of the balance sheet date of the consolidated financial statements (December 31, 2004). All annual financial statements of subsidiaries have been audited by independent auditors and in each case have been granted an unqualified audit opinion.

In the consolidation of equity, subsidiaries established by Software AG are consolidated at the date they were established. The date of first inclusion in the consolidated financial statements is taken as the date of consolidation for the companies SAG-E, SAG-P, SAG-CH, SIH, SQL, SAG-IRL and the Asian subsidiaries, which were initially consolidated in 1994. In the case of all other companies included in the consolidated financial statements, the acquisition date is selected as the consolidation date.

The initial consolidation of companies consolidated prior to December 31, 2002 followed the book value method in accordance with section 301, paragraph 1 no. 1 of the HGB. Accordingly, the acquisition and start-up costs were offset against the Group's investment in shareholders' equity. Initial consolidation after the transition to IFRS on January 1, 2003 followed the regulations set out in IFRS 3. Subsequent consolidations were based on the initial consolidation.

Goodwill arising from the consolidation of equity was offset against retained earnings for acquisitions prior to January 31, 2001 in accordance with section 309 paragraph 1 HGB. Goodwill arising after that date was capitalized in accordance with HGB accounting and amortized over 10 years using the straight-line method. In accordance with the option set out in IFRS 1.14, the Company continues to account for business combinations and the goodwill arising thereof on the date of transition to IFRS in accordance with HGB.

Goodwill previously capitalized in line with HGB accounting was measured in accordance with IAS 36 for fiscal 2003 and 2004. It was frozen at the carrying amount stated on the date of transition to IFRS on January 1, 2003, and only written down in case of actual impairments. Goodwill is annually tested for impairment.

Revenue, expenses and income, receivables and payables arising between consolidated companies have been eliminated. Inter-company earnings from services provided within the Group were also eliminated where these were not realized from services to third parties. Consolidated equity and net income allocable to minority interests are reported separately from consolidated equity and net income allocable to the parent company.

### **Currency translation**

Financial statements of foreign subsidiaries are translated according to the functional currency concept using the modified closing rate as set out in IAS 21. Since the subsidiaries operate independently from an organizational, financial and business standpoint, the local currency is identical with the functional currency.

Income and expenses are translated at monthly average rates, assets and liabilities at closing rates and equity in subsidiaries at historical rates. Currency translation differences arising from the consolidation of equity are excluded from income and reported in a separate column in the statement of changes in equity.

When eliminating receivables and liabilities, currency translation differences are recognized under other operating income and expenses on the income statement.

In the statement of fixed assets movements, the balances at the beginning and end of the fiscal year are converted at the applicable closing rates and other items at average rates. Any difference arising from exchange rate changes is displayed in a separate column under both costs and accumulated depreciation/amortization as an exchange difference.

Foreign currency payables and receivables are translated at the closing rate in the financial statements of consolidated companies. Exchange gains and losses not yet recognized on the balance sheet date are included in net income for the period except for translation differences from long-term, inter-company monetary items that are part of a net investment in a foreign company. These differences are excluded from income and recorded as other reserves in shareholders' equity.

The exchange rates of key currencies used for currency translation have changed against the euro as shown below:

#### Use of estimates

In the preparation of the consolidated financial statements, estimates and assumptions are made for certain items impacting the recognition and measurement of assets, liabilities and contingent liabilities as well as income and expenses reported. Actual amounts may differ from these estimates.

Closing rate (€ 1)			
	Dec. 31, 2004	Dec. 31, 2003	Change in foreign currency in %
US dollar	1.3640	1.2607	- 8.2
Pound sterling	0.7063	0.7063	0.0
Swiss franc	1.5435	1.5583	1.0
South African rand	7.6700	8.3300	7.9
Australian dollar	1.7510	1.6790	- 4.3

Average rate (€ 1)			
	2004	2003	Change in foreign currency in %
US dollar	1.2432	1.1309	- 9.9
Pound sterling	0.6785	0.6919	1.9
Swiss franc	1.5440	1.5207	- 1.5
South African rand	8.0126	8.5309	6.1
Australian dollar	1.6894	1.7384	2.8

## Accounting Policies

### Revenue

Software AG primarily generates revenue from software licenses of usually unlimited periods of usage, maintenance, and other services. Sales from perpetual software licenses are only posted as revenue once a contract has been signed with the customer, all possible rights of return have expired, the software has been delivered, a price has been agreed or can be established, and there is sufficient probability that payment will be made.

Maintenance revenues are prorated over the period of service provision.

Service agreements that are invoiced based on hours performed are recognized in relation to the services rendered by the Group companies.

Pursuant to IAS 11 and IAS 18, revenues and expenses from fixed-price service contracts are recognized according to the percentage-of-completion method if revenues can be reliably measured, there is sufficient probability that Software AG will receive the economic benefits of the transaction, and all related costs expected by completion of the service can be reliably established.

Revenues are reported net of discounts, price rebates, customer bonuses and allowances.

### Cost of sales

Costs of sales include all production-related costs based on normal capacity utilization. They include individual unit costs that can be directly allocated to projects, plus fixed and variable overheads. Financing costs are not capitalized as part of manufacturing costs. No write-downs on inventories were required during the reporting period.

### Research and development costs

Research and development costs are recorded as expense in the income statement as they are incurred.

The creation and development of software involves closely linked research and development phases. As a result, expenses incurred for research cannot be strictly separated from those incurred for development. The criteria for the capitalization of development expenses defined in IAS 38.57 in conjunction with 38.53 (revised 2004) are thus not met.

### Financing costs

Interest expense is recognized in the period in which it is incurred in accordance with IAS 23.

### **Cash and cash equivalents**

Software AG treats cash on hand, deposits with bank, fixed-term deposits with terms of up to 3 months and securities under current assets as cash and cash equivalents. The securities account includes exclusively short-term, highly liquid financial investments that can be converted to cash immediately and are subject only to minor price fluctuation risks.

The Company classifies all securities under current assets as "held-for-trading". Securities are initially recognized at cost on the day they are acquired. Measurement at the balance sheet date is at market value. Changes in value are included in income.

### **Inventories**

Inventories are recognized at the lower of cost and net realizable value. The net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

### **Trade receivables**

Trade receivables are carried at the fair value applicable when revenues are realized or services provided, and measured at amortized cost less bad debt provisions.

Receivables from software licenses are recognized only if there is a signed contract with the customer, any rights of return have expired and the software has been delivered in accordance with the terms of the contract.

Trade receivables are carried at their nominal value, unless specific write-downs were necessary to cover default risks. Receivables with maturities in excess of one year are discounted at market rates.

Trade receivables also cover performance under fixed-price projects not yet invoiced, which are recognized according to their degree of completion.

### **Other receivables and other assets**

Other receivables and other assets are initially measured at cost, and are subsequently written down to their fair value.

### **Intangible assets**

Intangible assets for which a useful life can be established, are measured at cost less any accumulated amortization and any accumulated impairment losses. Intangible assets with an indefinite useful life, such as goodwill, are carried at cost less any accumulated impairment losses.

### **Goodwill**

In accordance with IFRS 3, goodwill is not amortized, but written down in case of impairment. The residual amount is annually tested for impairment and written down to its fair value if there are any indications for impairment.

### Property, plant and equipment

Property, plant and equipment is carried at cost less any accumulated depreciation and any accumulated impairment losses. Where items are sold or scrapped, the relevant cost and any accumulated depreciation and any accumulated impairment losses are eliminated. Gains or losses arising from the disposal of the asset are recognized as income or expense in the income statement.

The cost of an item of property, plant and equipment includes the purchase price as well as any applicable import duties and non-refundable sales tax and all directly attributable costs required to prepare the asset for its intended use. Subsequent expenditure, such as service and maintenance charges that arise once the asset is put into operation, are recognized as expense in the period in which they are incurred. Subsequent expenditure relating to an item of property, plant and equipment is only added to the carrying amount of the asset where this improves the condition of the asset beyond its originally assessed standard of performance. Financing costs are not capitalized as part of costs.

In accordance with their useful economic lives, items of property, plant and equipment are generally depreciated using the straight-line method:

Buildings	50 years
Improvements to property	8 – 10 years
Office equipment	3 – 13 years
Computer hardware and accessories	1 – 4 years

The terms of useful life and depreciation methods are reviewed on a regular basis to ensure they are in accordance with the anticipated economic life of the asset in question.

Assets under construction are recorded as such. Depreciation on these items begins only after they have been completed and put into operation.

### Impairment of intangible assets and property, plant and equipment

As soon as there are indications that an intangible asset or item of property, plant and equipment is impaired, the carrying amount of the asset is reduced to its recoverable amount and an impairment loss is recognized. The recoverable amount is the higher of the asset's market value and its value in use. The value in use is the present value of estimated future cash flows expected to arise from the continuing use of the asset and from its disposal at the end of its useful life.

Impairment losses are reported under costs of the relevant functional area or under other operating expense.

**Financial assets**

Securities in the amount of €231 thousand comprise investments in securities' funds to cover the value of employee time accounts in case of insolvency.

**Leases**

Fixed assets include assets provided under leasing contracts. Software AG leases computer hardware and accessories, and office equipment. In accordance with IAS 17, leasing contracts are classified, according to opportunities and risks, as capital leases (where the leased asset is allocated to the lessee) or operating leases (where the leased asset is allocated to the lessor).

Leased objects are recognized on the balance sheet as both assets and lease obligations, in equal amounts. They are carried at the lower of the fair value of the lease object at the beginning of the lease and the present value of minimum lease payments. Capitalized leased objects are depreciated according to the straight-line method over their useful lives, or, if shorter, the lease term. Future lease payments are recognized as financial liabilities.

**Financial assets and hedging instruments**

Financial assets are initially recognized at cost, including transaction costs. The subsequent measurement depends on their classification.

Financial assets available for sale are recognized according to their market value at the balance-sheet date. Gains or losses are excluded from income and reported in equity as other reserves.

Financial assets are recorded at their fair value where this can be reliably established. Loans and receivables included under this item which are not held for trading purposes, and assets with no published price quotation on an active market, the fair value of which can not be reliably determined, are measured at amortized cost. Carrying amounts are regularly reviewed for significant objective indications of impairment. Impairment losses are charged against net income for the period.

**Deferred taxes**

Deferred tax assets and liabilities have been recognized for all temporary differences between the carrying amounts in accounts prepared for tax purposes and the carrying amounts in the financial statements, as well as with respect to consolidation measures with an impact on income. Deferred tax assets also include claims for tax reductions resulting from the anticipated use of loss carry forwards in subsequent years, the realization of which is deemed reasonably certain.

Deferred taxes are calculated on the basis of tax rates which apply or are anticipated in the relevant countries according to the legal situation prevailing at the time of realization (reversal of tax deferrals).

Deferred tax assets and liabilities are not discounted. The carrying values of deferred taxes are regularly examined and, where necessary, adjusted.

**Liabilities**

Current liabilities are reported at their repayment or settlement amount.

Non-current liabilities are recorded at amortized cost. Amortized cost is determined using the effective interest rate method by discounting the repayment amount.

**Provisions**

Provisions are set up in the event that a current legal or constructive obligation towards a third party exists due to a past event, which is likely to result in a future outflow and for which the amount of the obligation can be reliably estimated. Estimates are regularly reviewed and adjusted.

If the interest rate impact is significant, the net present value of required expenditures anticipated in fulfillment of the application is recorded.

**Provisions for pensions and similar obligations**

Pension plans may be either defined benefit plans or defined contribution plans. Pension provisions are calculated on an actuarial basis using the projected unit credit method set out in IAS 19. This approach takes into account anticipated future increases in pensions and salaries in addition to the pensions known at the balance sheet date.

Provisions for pensions are accounted for in line with the amendment to IAS 19, issued in December 2004. Accordingly, they are created at the full present value of the defined obligation, adjusted for the present value of the cover taken out to protect defined benefit obligations, and reduced by the fair value of plan assets. Changes to actuarial gains/losses in comparison to 2003 are excluded from income and allocated to retained earnings. Due to their absolute and relative immateriality (€-214 thousand), these amounts were included in income in the previous year.

German pension obligations are calculated on the basis of the 1998 mortality tables compiled by Prof. Dr. Klaus Heubeck.

Since employees do not receive illness-related allowances either domestically or abroad, calculation of costs related to health care plans is not required.

In the case of defined contribution plans the Group incurs no obligations.

For the defined contribution plan, Software AG has no obligations other than the payment of contributions to special-purpose funds. Contribution payments are recorded against current income.

## Comments to the profit and loss statement

### (1) Revenue

License and maintenance revenues can be broken down as follows according to business line:

€ thousands	XML		ETS		Other		Total	
	2004	2003	2004	2003	2004	2003	2004	2003
Licenses	26,080	26,199	85,907	76,878	2,227	1,203	114,214	104,280
Maintenance	21,162	21,535	156,738	165,805	4,665	3,896	182,565	191,236
Product sales	47,242	47,734	242,645	242,683	6,892	5,099	296,779	295,516

### Service revenues

Sales of €14,530 thousand are included in service revenues, recognized according to the percentage-of-completion method. Revenue and expense components of this item can be broken down as follows:

€ thousands	
Accumulated costs	12,868
Reported profit	2,587
Advance payments received	753
Sales recognition according to PoC method	14,530
Deductions	28

### (2) Cost of sales

Cost of sales include the following cost types:

€ thousands	2004	2003
Personnel expenses	77,186	80,646
Purchased services	26,519	30,034
Office rental and other tenancy costs	6,933	6,258
IT expenses	7,600	7,149
License fees	6,120	3,407
Car and travel expenses	6,056	6,932
Other expenses	6,988	17,307
	137,402	151,733

### (3) Research and development expenses

Research and development expenses are composed as follows:

€ thousands	2004	2003
Personnel expenses	30,544	46,628
IT expenses	10,765	11,282
Purchased services	3,449	1,338
Other expenses	4,246	2,585
	<b>49,004</b>	<b>61,833</b>

### (4) Sales costs

Sales costs include the following cost types:

€ thousands	2004	2003
Personnel expenses	53,734	54,422
Marketing expenses	7,679	9,689
Car and travel expenses	6,515	6,990
Office rental and other tenancy costs	5,915	5,665
Sales commissions	4,842	8,410
IT expenses	4,363	3,833
Other expenses	6,047	10,361
	<b>89,095</b>	<b>99,370</b>

### (5) General and administrative expenses

General and administrative costs are composed as follows:

€ thousands	2004	2003
Personnel expenses	34,882	41,284
Office rental and other tenancy costs	7,230	7,400
Other expenses	3,186	6,390
	<b>45,298</b>	<b>55,074</b>

**(6) Income from the sale of SAP-SI shares**

On April 14, 2004, Software AG sold 1,272,100 shares in SAP-SI at a price of €20.40 per share, resulting in proceeds of €25,951 thousand and income of €24,530 for the Group. Following the

sale, Software AG no longer holds any shares in SAP-SI.

**(7) Other Operating Income**

Other operating income includes the following accounts:

€ thousands	2004	2003
Exchange gains	5,589	4,851
Income from leases	2,868	2,546
Income from the release of provisions	2,087	3,115
Other income	3,013	7,283
	<b>13,557</b>	<b>17,795</b>

**(8) Other Operating Expenses**

Other operating expense includes the following accounts:

€ thousands	2004	2003
Legal costs	11,080	0
Exchange losses	3,912	2,227
Costs related to vacant premises	2,130	7,099
Other expenses	1,188	1,434
	<b>18,310</b>	<b>10,760</b>

Legal costs amounting to €11,080 thousand consist primarily of the legal cases presented under other disclosures.

Legal costs are shown in general and administrative expenses except for legal proceedings likely to incur high costs that are reclassified as other operating expenses. No significant expenses related to legal cases were required to be reclassified in the previous year.

**(9) Goodwill amortization**

Due to the planned closure of the IC Group B.V., Capelle, the Netherlands, in 2005, goodwill arising from the purchase of this company was fully written off in the year under review.

**(10) Interest result**

Due to a further increase in net liquidity in 2004, higher interest income of €3,253 thousand was achieved than in the previous year, despite lower interest rates.

Interest income is composed as follows:

€ thousands	2004	2003
Interest income	5,612	3,992
Interest expense	- 2,359	- 1,244
	<b>3,253</b>	<b>2,748</b>

**(11) Income taxes**

The Group's income tax can be classified according to its origin:

€ thousands	2004	2003
Current domestic taxes	- 2,674	687
Current foreign taxes	- 21,575	- 16,013
	<b>- 24,249</b>	<b>- 15,326</b>
Deferred domestic taxes	- 9,800	9,797
Deferred foreign taxes	1,000	1,328
	<b>- 8,800</b>	<b>11,125</b>
	<b>- 33,049</b>	<b>- 4,201</b>

In December of 2003, German legislators adopted a new law designed to reduce tax exemptions ("Act to Implement the Mediation Committee's Proposals to the Tax Privilege Reduction Act") effective January 1, 2004. The key changes in tax legislation with respect to calculation of Software AG income taxes is that since 2004, only 95 percent of domestic dividends and 95 percent of gains from the disposal of domestic and foreign investments continue to be tax-exempt; this implies that 5 percent of dividends and gains from disposals are to be considered non-deductible operating expenses. The effects of these changes are not material for the consolidated income statement of 2003.

The rise in current tax expense is mainly due to the introduction of the so-called minimum taxation (change in section 10 of the income tax code) effective for both parent and German subsidiaries for the assessment period 2004.

Expenses for current income taxes in the previous year amounting to €15,326 thousand are offset by income from the release of tax provisions of €4,942 thousand.

The change in deferred taxes is primarily the result of the utilization of tax loss carry forwards brought about by positive earnings growth in 2004.

Deferred taxes are calculated on the basis of tax rates which will apply at the anticipated time of realization in the relevant countries according to the legal situation prevailing at the time the consolidated financial statements are prepared. In Germany a uniform corporate tax rate of 25 percent applies. Taking into consideration an average municipal trade tax collection rate of 424 percent and the solidarity surcharge of 5.5 percent on corporate tax, an income tax rate of 39.9 percent is computed for domestic companies (previous year: 39.9 percent). Tax rates abroad range between 4.3 percent and 37 percent (previous year: between 4.3 percent and 37 percent).

Income tax expense reported in fiscal 2004 to the amount of €33,049 thousand (previous year: €-4,201 thousand) is €10,956 thousand less than the income tax expense anticipated of €-44,005 thousand (previous year: €-4,494 thousand), which would result from applying the domestic tax rate of 39.9 percent (previous year: 39.9 percent) at the consolidated level. The difference between expected and actual tax expense can be traced to the following causes:

€ thousands	2004	2003
Earnings before income tax	110,288	11,264
Expected income tax (39.9%; 39.9%)	- 44,005	- 4,494
Tax rate-related adjustments	15,505	3,101
Back taxes (+)/tax refunds (-) from previous years	- 222	4,263
Tax decreases (-)/tax increases (+) due to tax-exempt income or non-tax-deductible expenses	- 438	- 102
Other adjustments	- 3,889	- 6,969
<b>Reported income tax expense</b>	<b>- 33,049</b>	<b>- 4,201</b>

Back taxes/tax refunds in the previous year reflect the release of provisions due to the elimination of risks associated with tax audit.

Other adjustments mainly include expenses for dividend payments from subsidiaries resolved for the subsequent year of €-1,166 thousand (previous year: €0 thousand) and changes in the measurement of deferred tax assets from tax loss carry forwards amounting to €-737 thousand (previous year: €-7,201 thousand).

#### **(12) Other Taxes**

Other taxes mainly comprise of property taxes, vehicle tax and non-deductible sales tax.

#### **(13) Minority Interests**

Minority interest relates to 49 percent third-party holdings in the joint venture Software AG (India) Pvt. Ltd., Pune, India (SAG-IN) established jointly with iGate Solution Limited in 2003.

#### **(14) Earnings per Share**

The basic earnings per share figure is calculated by dividing net income allocable to shareholders by the weighted average number of shares outstanding during the period under review and presented accordingly. Software AG has issued only common shares.

Diluted earnings per share is equivalent to basic earnings per share, since an issue of new shares is not currently anticipated due to the exercise hurdle in the stock option plan.

## Comments to the consolidated Balance-sheet

### (15) Cash and Cash Equivalents

Cash and cash equivalents include cash on hand, bank balances, and short-term securities. The level of cash and cash equivalents rose during fiscal 2004 by €44,933 thousand to €119,092 thousand. This rise is due in the greater part to the positive cash flow generated by operating activities

amounting to €28,855 thousand, as well as sales proceeds from SAP-SI shares totaling €25,951 thousand. The reduction in financial obligations from finance leases of €3,170 thousand, as well as investment in intangible assets and property, plant and equipment of €6,031 thousand, provided an offsetting effect.

### (16) Trade Receivables

These items may be broken down as follows:

€ thousands	31.12.2004	31.12.2003
Remaining term < 1 year		
Trade accounts receivable	103,282	106,790
Unbilled receivables	6,392	2,203
	<b>109,674</b>	<b>108,993</b>
Remaining term > 1 year		
Trade accounts receivable	14,648	15,585
	<b>124,322</b>	<b>124,578</b>

### [17] Other Receivables and Other Assets

Other receivables and other assets primarily include receivables from tax authorities for input VAT as well as rental deposits.

### (18) Deferred Expenses

Deferred expenses reflect advance payments on the part of SAG associated with license and lease agreements. The accrual is released and the expense recorded in the period in which the relevant contracting partner provides the service.

## Changes to Fixed Assets as of December 31, 2004

€ thousands	Goodwill	Intangible assets	Land and buildings	Other plant, office furniture and equipment	Financial assets	Total
<b>Cost of purchase</b>						
Balance as of Jan. 1, 2004	218,245	30,401	58,388	47,891	8,239	363,164
Currency translation differences	0	- 46	- 671	- 796	0	- 1,513
Additions	0	613	1,509	4,197	130	6,449
Disposals	0	- 1,054	- 401	- 5,064	- 2,016	- 8,535
Balance as of Dec. 31, 2004	218,245	29,914	58,825	46,228	6,353	359,565
<b>Accumulated depreciation/amortization</b>						
Balance as of Jan. 1, 2004	- 41,773	- 28,910	- 24,372	- 34,027	13,300	- 115,782
Currency translation differences	0	43	599	692	0	1,334
Additions	- 1,881	- 581	- 1,708	- 6,979	- 3	- 11,152
Disposals	0	1,050	310	4,706	- 18,058	- 11,992
Balance as of Dec. 31, 2004	- 43,654	- 28,398	- 25,171	- 35,608	- 4,761	- 137,592
Net book value as of Jan. 1, 2004	176,472	1,491	34,016	13,864	21,539	247,382
Net book value as of Dec. 31, 2004	174,591	1,516	33,654	10,620	1,592	221,973

**(19) Intangible Assets**

This account is composed primarily of acquired software licenses.

**(20) Goodwill**

Goodwill is the result of the acquisition of the SAG-USA Group effective February 1, 2001, amortized until January 1, 2003.

**(21) Land and buildings**

Land and buildings mainly consist of assets that belong to the parent company. Primarily this refers to the central administration building of the controlling company.

Capital expenditures of €1,509 thousand were made to the administration building of Software AG and to the administration building of Software AG España S.A., Madrid, Spain.

**(21) Other plant, office furniture and equipment**

Other plant, office furniture and equipment primarily includes office furniture and IT equipment acquired under finance leases.

Capital expenditures of €4,197 thousand were incurred as part of the modernization of the IT infrastructure, as well as renovation measures to the main headquarter building in Darmstadt.

**(22) Financial Assets**

Financial assets to a large extent reflect assets held to cover long-term employee time accounts in the case of insolvency.

**(23) Deferred Tax Assets and Liabilities**

The balance of deferred tax assets and liabilities, calculated according to the liability method, for individual balance sheet accounts is shown in the following breakdown:

€ thousands	Deferred tax assets		Deferred tax liabilities	
	2004	2003	2004	2003
Securities	290	338	819	456
Current assets	39	152	304	783
Goodwill	5,482	5,867	0	0
Property, plant and equipment	1,514	1,569	3,471	3,609
Tax loss carry forwards	27,021	29,783	0	0
Current debt	5,667	5,872	6,813	7,818
Non-current debt	7,746	13,845	22,015	18,142
Consolidation measures	- 5,482	- 5,867	- 20,979	- 18,010
	<b>42,277</b>	<b>51,559</b>	<b>12,443</b>	<b>12,798</b>
Write-downs	- 6,600	- 6,600	0	0
	<b>35,677</b>	<b>44,959</b>	<b>12,443</b>	<b>12,798</b>

Deferred tax assets and liabilities are broken down as follows with respect to maturity:

€ thousands	2004	2003
<b>Deferred tax assets</b>		
Short term	5,968	6,329
Long term	29,709	38,630
	<b>35,677</b>	<b>44,959</b>
<b>Deferred tax liabilities</b>		
Short term	7,936	8,147
Long term	4,507	4,651
	<b>12,443</b>	<b>12,798</b>

Deferred tax assets from tax loss carry forwards have decreased by €2,762 thousand compared to the previous year. This is to a great degree the result of additional utilization of tax loss carry forwards, in particular in the case of Software AG.

Write-downs of deferred tax assets are undertaken if there are doubts as to their realization. To determine these write-downs, all positive and negative factors that might impact the achievement of future taxable income have been taken into consideration. Assumptions made in this respect may change depending on future developments. The write-down account is due solely to tax loss carry forwards pertaining to the parent company for both 2003 and 2004.

As of December 31, 2004, nominal tax loss carry forwards for the Group exist in the amount of €87,836 thousand (previous year: €90,857 thousand). In principle these may be utilized at any time in the future, save for a partial amount of €6,269 thousand (previous year: €3,742 thousand).

Deferred taxes on earnings retained by foreign subsidiaries are not taken into account, since these earnings are expected to be utilized for the maintenance and expansion of business volumes in the companies in question.

Tax provisions amounting to €1,166 thousand (previous year: €0 thousand) pertain to tax charges from dividend payments of foreign subsidiaries resolved at the beginning of 2005.

#### (24) Financial Liabilities

Financial liabilities may be broken down as follows:

€ thousands	31.12.2004	31.12.2003
<b>Current financial liabilities</b>		
Liabilities from finance leases	2,114	4,009
Bills payable	1,235	2,537
	<b>3,349</b>	<b>6,546</b>
<b>Non-current financial liabilities</b>		
Liabilities from finance leases	3,490	4,356
	<b>3,490</b>	<b>4,356</b>

Financial liabilities stemming from finance leases may be broken down as follows as of December 31, 2004:

	Within 1 year	1 to 5 years	> 5 years	Total
Lease payments	2,460	3,736	0	6,196
Of which interest	- 346	- 246	0	- 592
Net present value of lease installments	2,114	3,490	0	5,604
Expected income from sub-leases	0	0	0	0

### (25) Trade Payables

Trade payables can be broken down as follows:

€ thousands	31.12.2004	31.12.2003
Payables to suppliers	19,787	24,090
Advances received on orders	1,405	2,631
Other	0	49
	<b>21,192</b>	<b>26,770</b>

### (26) Other Liabilities

Other liabilities include the following accounts:

€ thousands	31.12.2004	31.12.2003
Tax liabilities	7,614	9,331
Liabilities to employees	6,671	8,666
Liabilities related to social security	2,746	4,730
Other	5,248	2,567
	<b>22,279</b>	<b>25,294</b>

**(27) Other Provisions**

€ thousands	Other employee-related provisions	Restructuring provisions	Other sundry provisions	Total other provisions
Balance at 01.01.2004	12,864	30,682	27,956	71,502
Currency translation	- 251	- 84	- 273	- 608
Additions	10,613	0	10,546	21,159
Utilized	- 10,018	- 22,121	- 20,485	- 52,624
Released	- 519	- 971	- 3,776	- 5,266
Balance at 31. 12. 04	12,689	7,506	13,968	34,163
Thereof with remaining term > 1 year	542	0	364	906

**Other sundry provisions**

Other sundry provisions include:

€ thousands	31. 12. 2004	31. 12. 2003
Rental payment obligations	5,365	13,778
Litigation risks	4,673	4,586
Executive Board bonuses	1,610	1,450
Guarantees for PS projects	476	1,176
Impending losses for PS projects	466	5,322
Other	1,378	1,644
	13,968	27,956

**(28) Provisions for pensions**

€ thousands	
Balance at January 1, 2004	19,666
Currency translation	- 45
Additions	2,940
Utilized	- 385
Released	- 27
Balance at December 31, 2004	22,149

€ thousands	31.12.2004	31.12.2003
Provisions for pensions abroad	13,317	10,680
Provisions for pensions domestically	8,832	8,986
	<b>22,149</b>	<b>19,666</b>

Pension commitments in Germany consist of fixed commitments to a selected group of employees.

A portion of these commitments is covered by life-insurance policies. The remaining defined-benefit pension obligations abroad are covered to a large extent by external funds.

Principal actuarial assumptions				
%	German pension plans		Non-German plans <sup>1</sup>	
	2004	2003	2004	2003
Discount rate	4.5	4.5	5.2	5.6
Future salary increases	0.0	0.0	4.0	4.7
Future pension increases	0.0	0.0	2.7	2.7
Expected return on plan assets	4.5	4.5	6.6	6.8
Development of defined benefit obligation	- 0.1	6.8	22.5	7.4

<sup>1</sup> Weighted average figures for individual plans

Since fixed pension commitment entitlements independent of salary exist for beneficiaries of the domestic plans, future salary and pension increases are set at 0.0 percent.

Non-German pension commitments are calculated according to country-specific accounting principles and parameters.

As cover for German pension commitments is only provided by life-insurance policies, the figure quoted for expected return on plan assets is the minimum return quoted by the life-insurance company.

The expected return on plan assets for non-German programs was calculated as a weighted average of the individual asset classes, which in turn were based on the relevant local capital-market conditions.

The computation of pension expense is based on planned service cost and the anticipated return on

the plan assets. Changes in the projected benefit obligations and plan assets are shown below:

Changes in projected benefit obligations				
€ thousands	Domestic pension plans		Foreign pension plans	
	2004	2003	2004	2003
Projected benefit obligation as of January 1	9,257	8,664	25,749	23,978
Service cost	165	145	1,386	1,455
Interest expense	394	403	1,455	1,231
Actuarial gains (-)/losses (+)	37	434	2,998	- 220
Benefits paid	- 389	- 389	- 102	0
Currency changes	0	0	- 223	- 695
<b>Projected benefit obligations at December 31</b>	<b>9,464</b>	<b>9,257</b>	<b>31,263</b>	<b>25,749</b>

Changes in plan assets				
€ thousands	Domestic pension plans		Foreign pension plans	
	2004	2003	2004	2003
Fair value of plan assets as of January 1	271	186	15,069	13,022
Return on plan assets	23	12	1,354	806
Employer contributions	194	59	1,708	1,580
Compensation for pension claims	144	14	0	0
Benefits paid	0	0	- 102	0
Currency changes	0	0	- 83	- 339
<b>Fair value of plan assets as of December 31</b>	<b>632</b>	<b>271</b>	<b>17,946</b>	<b>15,069</b>
<b>Provisions for pensions</b>	<b>8,832</b>	<b>8,986</b>	<b>13,317</b>	<b>10,680</b>

Pension provisions have developed as follows from the time of the transition at January 1, 2003:

€ thousands	31.12.2004	31.12.2003	01.01.2003
Defined benefit obligation (DBO)	40,727	35,006	32,642
Present value of plan assets	- 18,578	- 15,340	- 13,208
<b>Provisions for pensions</b>	<b>22,149</b>	<b>19,666</b>	<b>19,434</b>

Since differences between the expected and actual developments in projected benefit obligations and plan assets are relatively low, no planned to actual comparison has been performed.

Projected benefit obligations can be broken down according to type of reinsurance as shown below:

€ thousands	31. 12. 2004	31. 12. 2003	01. 01. 2003
Projected benefit obligations fully covered by capital	30,657	24,954	23,379
Projected benefit obligations partially covered by capital	7,704	7,863	7,574
Projected benefit obligations without capital coverage	2,366	2,189	1,689
	<b>40,727</b>	<b>35,006</b>	<b>32,642</b>

Plan assets to cover the pension provisions are composed as follows:

€ thousands	31. 12. 2004	31. 12. 2003	01. 01. 2003
Shares	9,546	7,518	4,872
Bonds	5,328	6,220	5,390
Life insurance	632	271	186
Other	3,072	1,331	2,760
	<b>18,578</b>	<b>15,340</b>	<b>13,208</b>

Realized gains in plan assets developed as follows:

€ thousands	2004	2003	2002
Realized gains	<b>1,377</b>	818	824

Since realized gains in plan assets differed only insignificantly from planned gains, no planned to actual comparison has been performed in this instance.

Anticipated contributions on the part of the Software AG Group to plan assets in fiscal 2005 total €1,914 thousand.

Actuarial gains and losses have developed as follows from the time of the transition at January 1, 2003:

€ thousands	2004	2003
Actuarial gains	279	220
Actuarial losses	2,701	434
<b>Actuarial net loss</b>	<b>2,422</b>	<b>214</b>
Of which included in other provisions	2,422	0
Of which recognized as expense	0	214

Expenses related to pension obligations recorded in the income statement are broken down as follows:

€ thousands	2004	2003
Service cost	1,551	1,600
Interest expense	1,849	1,634
Past service cost	0	0
Compensation, transfers and reductions	0	0
	<b>3,400</b>	<b>3,234</b>

Expenses were recorded in the profit and loss statement as follows:

€ thousands	2004	2003
Cost of sales	1,068	1,010
Research and development expenses	389	368
Selling expenses	992	937
General and administrative expenses	951	919
	<b>3,400</b>	<b>3,234</b>

**(29) Tax provisions**

€ thousands	
Balance at January 1, 2004	10,929
Currency translation	28
Additions	8,475
Utilized	- 5,140
Released	- 1
Balance at December 31, 2004	14,291

**(30) Deferred income**

Deferred income reflects advance payments from customers associated with revenues from maintenance agreements. The release of deferred income will be realized in the period in which SAG provides the service.

**(31) Equity**

Changes in equity are shown in the Statement of Changes in Equity preceding the notes to the consolidated financial statements.

The following conditional capital existed as of December 31, 2004:

1.) A maximum of €3,357 thousand divided into a maximum of 1,118,962 bearer shares to provide for subscription rights from the first share option plan (Management Incentive Plan I, MIP I) for members of the Executive Board and key employees in the Group. Requirements of this program, the status of allocations and exercising options are presented under other disclosures/stock-based compensation programs.

2.) A maximum of €3,000 thousand divided into a maximum of 1,000,000 bearer shares to provide for subscription rights from the second share option plan (Management Incentive Plan II, MIP II) for members of the Executive Board and key employees of the SAG Group. Requirements of this program, the status of allocations and exercising options are presented under other disclosures/stock-based compensation programs.

3.) An amount of €36,000 divided into a maximum of 12,000,000 bearer shares with a proportional share in capital stock of €3 each, in order to grant option rights and agree option obligations from bonds with warrants or, to bearers of convertible bonds, conversion rights and conversion obligations according to the bond conditions, as resolved at the Annual Shareholders' Meeting on April 30, 2004. According to this authorization, the Executive Board may, with the consent of the Supervisory Board, resolve that the rights presented may be issued by Software AG or a directly or indirectly held fully owned affiliate of Software AG, up to April 29, 2009.

Subscription rights are hereby to be granted to shareholders with the exception of the following cases:

- The Executive Board is authorized to exclude fractional amounts from the shareholders' subscription rights.

- The Executive Board is authorized, with the consent of the Supervisory Board, to set aside the subscription rights of shareholders in full, provided it has reached the opinion after reviewing in accordance with its professional duties that the issue price of the warrants or convertible bonds is not significantly lower than its hypothetical market value arrived at by accepted financial calculation methods. This authorization, however, applies only to the waiving of subscription rights in the case of warrant and convertible bonds with a warrant or conversion right or a warrant and conversion obligation related to shares at the lower of a proportional amount of stock capital totaling a maximum of €8,180 thousand or 10 percent of stock capital in existence at the time the authorization is acted upon.
- The Executive Board is further authorized, with the consent of the Supervisory Board, to set aside subscription rights for capital increases against non-cash contributions for purposes of acquiring investments or companies in part or in whole.
- The Executive Board is also authorized, with the consent of the Supervisory Board, to set aside subscription rights for capital increases against cash contributions, in the event that the capital increases resolved based on this authorization do not exceed 10 percent of stock capital at the time of the first utilization of the authorization and in the event that the issue price is not significantly lower than the stock market price.
- Finally, the Executive Board is authorized, with the consent of the Supervisory Board, to set aside subscription rights to a maximum nominal value of €6,503 thousand, for the purpose of offering the new shares to employees of the Company and its affiliated companies as defined in sections 15 et seq. of the German Stock Corporation Act as part of an employee participation scheme. Distribution of the new shares can also be undertaken by a bank, with the proviso that they are exclusively held for the acquisition of entitled employees, according to the Company's instructions.

The Executive Board had not made use of this authorization prior to the balance sheet date.

As of the balance sheet date, the Executive Board is also authorized, with the consent of the Supervisory Board, to increase the company's issued capital stock on one or more occasions on or before April 27, 2006, by up to a total of €37,989 thousand by issuing up to 12,663,036 bearer shares against cash and/or non-cash capital contributions (authorized capital). Subscription rights are hereby to be granted to shareholders with the exception of the following cases:

- The Executive Board is authorized to exclude fractional amounts from the shareholders' subscription rights.

The Executive Board had not made use of this authorization prior to the balance sheet date.

The Executive and Supervisory Boards recommend to the Annual Shareholders' Meeting that a dividend of €20,450 thousand should be paid out and €42,505 thousand carried forward from the unappropriated profits total €62,955 for 2004 of the Group controlling company Software AG. This corresponds to a dividend of €0.75 per share.

**(32) Other Reserves**

Other reserves include differences arising from the currency translation of the financial statements of economically independent foreign subsidiaries into euros. They also contain the effects of the measurement of financial instruments, which are not taken to income. Translation differences from monetary items primarily consisting of net investments in independent foreign sub-units are also recorded in this account. These amounts are recognized on an after-tax basis.

**(33) Minority Interests**

Minority interest relates to 49 percent third-party holdings in the joint venture Software AG (India) Pvt. Ltd., Pune, India (SAG-IN) established with iGate Solution Limited in 2003.

**(34) Notes to the Cash Flow Statement**

Cash and cash equivalents of €119,092 thousand is composed of the balance sheet accounts of cash on hand and bank balances (€89,397 thousand) and securities (€29,695 thousand). Only short-term, highly liquid financial investments, subject to minimal price fluctuations, are reported in the securities account.

Net cash from operating activities includes restructuring payments totaling €23,429 thousand. Moreover, interest payments of €2,360 thousand, and interest receipts of €5,353 thousand, are included. Cash inflows from the disposal of SAP-SI shares

are reported under cash flow from investment activities. Cash outflows for capital expenditures in property, plant and equipment and intangible assets stem primarily from renovation measures taken in the corporate headquarters building and the SAG-E building, as well as the purchase of office equipment and hardware and software.

Changes in financial assets are based mainly on regular adjustments of securities positions in order to cover existing employee time accounts in the case of insolvency.

Acquisitions under finance leases in the amount of €288 thousand were undertaken in fiscal 2004. These non-cash transactions are not reflected in the cash flow statement.

While €2,869 thousand in liabilities from earlier acquisitions was repaid in the previous year, the account repayment of loans from acquisitions and other finance liabilities contain only the repayment of obligations under finance leases amounting to €3,170 thousand in 2004.

Changes in value of the balance sheet account cash and cash equivalents, stemming from the decline in key exchange rates, are reported separately as valuation-related changes in cash and cash equivalents at €-1,412 thousand.

Software AG defines free cash flow as cash flow from operating activities from which payments for property, plant and equipment have been deducted. Organic cash flow is the result of the elimination of special effects according to the table below:

€ thousands	2004	2003
Net cash provided by operating activities	28,855	13,510
Expenditures on property, plant and equipment and intangible assets	- 6,031	- 6,329
Investment in financial assets	- 846	- 1,292
<b>Free cash flow</b>	<b>21,978</b>	<b>5,889</b>
+ Repayment of factoring	+ 11,200	+ 24,600
+ Payments for restructuring	+ 23,429	+ 18,637
- Tax refunds from previous periods	- 1,930	0
+ Back taxes for previous periods	0	+ 6,005
<b>Organic cash flow</b>	<b>54,677</b>	<b>55,131</b>

### (35) Other liquidated provisions

€18,174 thousand in unrealized income recorded in other reserves as of December 31, 2003, were taken to income in fiscal 2004.

## Segment report for the twelve months ended December 31, 2004

€ thousands	Northern Europe, Americas	South	Central Europe/ Asia	Total Region	Development Central function Consolidation	Total Group
Licenses	49,720	32,290	32,560	114,570	- 356	114,214
Maintenance	100,252	31,378	51,547	183,177	- 612	182,565
Services	20,912	65,486	26,990	113,388	- 560	112,828
Other	476	503	262	1,241	523	1,764
<b>Total revenue</b>	<b>171,360</b>	<b>129,657</b>	<b>111,359</b>	<b>412,376</b>	<b>- 1,005</b>	<b>411,371</b>
<b>Operating result (EBITA)</b>	<b>48,996</b>	<b>12,876</b>	<b>19,412</b>	<b>81,284</b>	<b>4,535</b>	<b>85,819</b>
Income from investment sales					24,539	24,539
<b>EBITA as reported in income statement</b>	<b>48,996</b>	<b>12,876</b>	<b>19,412</b>	<b>81,284</b>	<b>29,074</b>	<b>110,358</b>
Amortization		- 1,881		- 1,881		- 1,881
<b>EBIT</b>	<b>48,996</b>	<b>10,995</b>	<b>19,412</b>	<b>79,403</b>	<b>29,074</b>	<b>108,477</b>
Interest result						3,253
<b>Profit before tax</b>						<b>111,730</b>
Taxes						- 34,491
<b>Net income</b>						<b>77,239</b>
Minority interest						- 114
<b>Consolidated income</b>						<b>77,125</b>
Depreciation	2,909	3,427	715	7,051	4,101	11,152
Segment assets/total assets	254,478	75,359	26,350	356,187	154,498	510,685
Investments	0	721	0	721	0	721
Segment liabilities/total liabilities	77,177	30,317	17,974	125,468	61,615	187,083
Capital expenditure	824	1,702	452	2,978	3,341	6,319
Non-cash income	219	973	2,218	3,410	4,319	7,729
Non-cash expenses	16,017	6,266	5,611	27,894	10,369	38,263
Employees	475	898	416	1,789	649	2,438

## Segment report for the twelve months ended December 31, 2003

€ thousands	Northern Europe, Americas	South	Central Europe/ Asia	Total Region	Development Central function Consolidation	Total Group
Licenses	53,778	22,459	28,173	104,410	- 130	104,280
Maintenance	109,256	31,291	51,224	191,771	- 535	191,236
Services	22,112	68,599	34,443	125,154	- 2,283	122,871
Other	1,026	257	180	1,463	192	1,655
<b>Total revenue</b>	<b>186,172</b>	<b>122,606</b>	<b>114,020</b>	<b>422,798</b>	<b>- 2,756</b>	<b>420,042</b>
<b>Operating result (EBITA)</b>	<b>47,835</b>	<b>18,601</b>	<b>12,524</b>	<b>78,960</b>	<b>- 19,893</b>	<b>59,067</b>
Restructuring expenses	- 2,304	- 4,541	- 10,333	- 17,178	- 31,614	- 48,792
<b>EBITA as reported in income statement</b>	<b>45,531</b>	<b>14,060</b>	<b>2,191</b>	<b>61,782</b>	<b>- 51,507</b>	<b>10,275</b>
Interest result						2,748
<b>EBIT</b>					<b>13,023</b>	
Taxes						- 5,960
<b>Net Income</b>						<b>7,063</b>
Minority interest						33
<b>Consolidated income</b>						<b>7,096</b>
Depreciation	4,187	1,537	646	6,370	4,383	10,753
Segment assets/total assets	273,191	61,591	31,302	366,084	139,558	505,642
Investments		724		724		724
Segment liabilities/total liabilities	83,197	31,639	33,320	148,156	88,165	236,321
Capital expenditure	1,768	3,059	798	5,625	5,421	11,046
Non-cash income	1,099	2,114	1,002	4,215	4,521	8,736
Non-cash expenses	15,098	10,248	15,723	41,069	27,315	68,384
Employees	504	840	435	1,779	798	2,577

## Comments to segment reporting

Segment reporting is prepared according to IAS 14 (Segment Reporting). Segmentation is defined along internal control and reporting lines in the Group. It was a decision of management to restructure the Group in 2004. The four geographic regions that had existed hitherto were amalgamated into three regions. This accurately reflects the new direction

in control. Since the parent company Software-AG, the research and development companies SAG-IN, SQL, SAG-IRL and the non-operational sub-holding SIH and SAG-MK report inter-company sales almost exclusively, these companies were included in the column "research and development, central functions and consolidations".

**Regions in 2004:**

- 1.) The Northern Europe/USA segment includes the SAG-USA Group (excluding revenues from sales partners in Israel, Japan and the business division of Latin America), SAG-CAN, SAG-UK, SAG-DK, SAG-N, SAG-S, SAG-SF, SAG-ZA, as well as revenues from the sales partner in South Africa.
- 2.) The Southern and Western Europe segment encompasses the companies SAG-E, with its subsidiaries SAG-P and SAG-ESYS, SAG-F, SAG-I, SAG-B, SAG-NL with its subsidiaries the IC Group and SAG-MS, SAG-TR, SAG-MEX and the business division of Latin America of the SAG-USA Group and the business division of Greece of the SAG-ME company.
- 3.) The Central and Eastern Europe, Asia segment is composed of the companies SAG-D, SAG-ME (without revenues from the business unit, Greece), SAG-PL, SAG-CS, SAG-A, SAG-CH, SAG-AUS (holding company), SAG-AUS, SAG-PHI, SAG-HK, SAG-TW, SAG-SIN, SAG-AP, SAG-MAL and revenues from sales partners Israel and Japan of the SAG-USA Group.

**Regions in 2003:**

- 1.) The America segment includes the SAG-USA Group (without revenues from sales partners in Japan, South Africa and Israel), SAG-CAN and SAG-MEX.
- 2.) The Southern and Western Europe segment includes the companies SAG-E with its subsidiary SAG-P, SAG-F, SAG-I, SAG-B, as well as SAG-NL with its subsidiaries IC Group and SAG-MS.
- 3.) The Northern Europe, Asia/Pacific segment is composed of the companies SAG-UK, SAG-HK, SAG-MAL, SAG-SIN, SAG-TW, SAG-AP, SAG-PHI, SAG-AUS (holding company), SAG-AUS, SAG-ZA, SAG-DK, SAG-N, SAG-S, SAG-SF and revenues from sales partners of the SAG-USA Group in Japan and South Africa.
- 4.) The Central and Eastern Europe segment comprises the companies SAG-D, SAG-ME, SAG-A, SAG-CH, SAG-CS, SAG-TR, SAG-PL, as well as revenues from the SAG-USA Group sales partner in South Africa.

The figures for the previous year were adapted to reflect the new structure.

In order to facilitate the reconciliation, segments are shown according to the old and new structures for both years 2003 and 2004. Key figures for 2004 and the preceding year have also been presented according to the former structure in order to enhance transparency.





## First-time application of IFRS

### Significant differences in accounting practices between IFRS/IAS and German commercial law (HGB)

#### Accounting policies

Pursuant to IFRS 1, International Accounting Standards (IAS)/International Financial Reporting Standards (IFRS) are applied retrospectively upon their initial adoption. Figures from previous periods are adjusted as if they were originally reported under IAS/IFRS.

The application of new standards published as part of the International Accounting Standards Board Improvement Project in December 2003 was not compulsory until January 1, 2005. They have only been applied to these financial statements where explicitly stated in these notes.

During fiscal 2004, new standards were published that come into force January 1, 2005 or later. Of these, Software AG chose to apply the provisions of IFRS 3 relating to the impairment testing of goodwill.

Accounting and valuation rules that differ significantly from the German Commercial Code include:

- Goodwill is subject to regular impairment tests; no scheduled amortization is undertaken.
- Securities available-for-sale are measured at fair value, even if this exceeds cost. Price gains or losses are excluded from income and recorded as other reserves in shareholders' equity.
- Derivatives are measured at market value, even if this exceeds cost. Price losses and gains are reported in the income statement.
- Revenue of fixed price contracts is recognized according to the stage of completion.
- Buildings are depreciated according to the anticipated useful life and not according to tax scales.
- Leases that qualify as finance leases under the more restrictive IFRS requirements are reported under both assets and lease liabilities in the balance sheet.
- Provisions are only created for obligations to third parties provided the probability of an outflow of resources is regarded as more likely to occur than not. Medium and long-term provisions are recorded at net present value. Provisions for neglected maintenance and other expense provisions are no longer created.

- Pension provisions are calculated according to the projected unit credit method.
- Under IFRS deferred tax liabilities and deferred tax assets should be recognized for all temporary differences arising between taxable balance and trade balance; quasi-permanent differences are also classified as temporary. Deferred taxes are measured on the basis of tax rates expected to apply at the anticipated time of the reversal of the deferral – i.e. when the asset is realized or the liability settled – according to the legal situation prevailing in the individual countries at the time the financial statements are prepared. According to the provisions of the German Commercial Code only deferred tax assets and deferred tax liabilities related to consolidation measures are required to be recorded. Deferred taxes are thereby calculated based on tax rates applicable at the balance sheet date. Deferred taxes may not be recorded for quasi-permanent differences between amounts in the financial statements for tax purposes and the consolidated financial statements that will only be realized in the longer term or in the case of sale of an asset or liquidation. A deferred tax asset should be recognized for the carry forward of unused tax losses to the extent that it is probable that future taxable profit will be available against which the unused tax losses can be utilized. Under German accounting law, deferred tax assets for tax loss carry forwards were only permitted to be created starting in fiscal 2003 pursuant to DRS 10. Deferred tax assets, netted against deferred tax liabilities that may be offset, increase by €38,060 thousand as of January 1, 2003. This is to a great degree the result of additional utilization of tax loss carry forwards, as well as the accounting and measurement of provisions. According to IFRS deferred tax liabilities of €17,006 thousand should be recorded; they pertain mainly to deferred taxes arising from deferred revenue and carrying amounts in property, plant and equipment.
- Monetary items in foreign currency are measured at the rate applicable on the balance sheet date and recognized in net income for the period. Translation differences from long-term, inter-company monetary items that are part of a net investment in a foreign company constitute an exception to the above and are included in other reserves in shareholders' equity without impacting income.

## Reconciliation of the Balance Sheet from HGB to IFRS at January 1, 2003

## Assets

€ thousands		HGB	Income Statement/ Equity	Reclassifications	IFRS
	Note	01.01.2003	related changes		01.01.2003
<b>A. Current Assets</b>					
Cash on hand and bank balances		75,423	0	0	75,423
Securities		0	0	0	0
Inventories	(1)	4,628	0	- 3,873	755
Trade receivables					
Other receivables and other assets	(1)	101,191	616	3,873	105,680
Deferred expenses					
Cash on hand and bank balances	(2)	10,395	1,048	0	11,443
Securities		6,947	0	0	6,947
		<b>198,584</b>	<b>1,664</b>	<b>0</b>	<b>200,248</b>
<b>B. Non-current assets</b>					
Intangible assets		1,551	0	0	1,551
Goodwill		176,591	0	0	176,591
Property, plant and equipment	(3)	37,000	15,776	0	52,776
Financial assets	(4)	5,937	9,909	- 3,588	12,258
Trade receivables					
Deferred taxes		20,969	0	0	20,969
Intangible assets	(5)	188	38,060	0	38,248
		<b>242,236</b>	<b>63,745</b>	<b>- 3,588</b>	<b>302,393</b>
<b>Total assets</b>		<b>440,820</b>	<b>65,409</b>	<b>- 3,588</b>	<b>502,641</b>

Equity and liabilities					
€ thousands		HGB	Income Statement/ Equity	Reclassifications	IFRS
	Note	01.01.2003	related changes		01.01.2003
<b>A. Current liabilities</b>					
Current financial liabilities	(6)	3,395	3,016	0	6,411
Trade payables	(7)	13,992	0	8,474	22,466
Other current liabilities	(7)	18,046	0	12,934	30,980
Current provisions	(8)	71,645	- 16,110	- 28,705	26,830
Tax provisions		26,305	0	0	26,305
Deferred income		81,728	0	0	81,728
		<b>215,111</b>	<b>- 13,094</b>	<b>- 7,297</b>	<b>194,720</b>
<b>B. Non-current liabilities</b>					
Non-current financial liabilities	(6)	0	8,395	0	8,395
Trade payables					
Other non-current liabilities		0	0	0	0
Provisions for pension	(7)	448	0	198	646
Non-current provisions	(9)	8,781	10,653	0	19,434
Deferred taxes	(7)	0	0	3,511	3,511
Non-current financial liabilities	(5)	2,012	14,994	0	17,006
		<b>11,241</b>	<b>34,042</b>	<b>3,709</b>	<b>48,992</b>
<b>C. Equity</b>					
Share capital		81,800	0	0	81,800
Capital reserve		132	0	0	132
Retained earnings		132,959	34,552	- 18,153	149,358
Consolidated income		0	0	0	0
Currency translation differences		- 423	0	423	0
Other reserves	(10)	0	9,909	17,730	27,639
		<b>214,468</b>	<b>44,461</b>	<b>0</b>	<b>258,929</b>
<b>Total equity and liabilities</b>		<b>440,820</b>	<b>65,409</b>	<b>- 3,588</b>	<b>502,641</b>

Comments to the reconciliation of the Balance Sheet from HGB to IFRS at January 1, 2003:

- (1) Work in progress as defined by HGB was recognized and posted as non-invoiced receivables according to the per-centage of completion method (including a portion of the margin).
- (2) Derivative instruments are valued at fair market value, even where this exceeds the cost of acquisition.
- (3) Depreciation of property was adjusted to take account of expected useful economic life. Assets from capital leases were capitalized.
- (4) This change is a result of the fair-market valuation of securities. The change is included in other comprehensive income under equity, but not recognized in net profit or loss for the period.
- (5) Deferred tax assets are primarily formed for loss carryforwards and provisions. Deferred tax liabilities are primarily formed for deferred expense and property, plant and equipment.
- (6) Long and short-term financial liabilities include capitalized liabilities from capital leases.
- (7) Certain provisions under HGB were reclassified as short or long-term liabilities to comply with IFRS.
- (8) The adjustment of provisions (recognized in net profit or loss) primarily comprises dissolved provisions for expenses (maintenance, guarantees) and provisions where the probability of the obligation having to be settled is less than 50 percent (legal costs, contingent losses, general risks). Reclassifications comprise provisions which, according to IFRS, are to be posted as liabilities. See also note (7).
- (9) The increase in pension provisions is primarily a result of the requirement under IFRS to include indirect pension obligations at SAG UK. These were not previously included, in accordance with the option granted by Article 28 of the Introductory Act to the German Commercial Code (EGHGB).
- (10) Other reserves includes unrealized gains from the fair-market valuation of securities and differences from the translation of long-term intra-Group cash positions in foreign currencies (i.e. not in euros).

#### Reconciliation of the Equity from HGB to IFRS at January 1, 2003

€ thousands	Note	
<b>Equity in accordance with HGB at 01.01.2003</b>		<b>214,468</b>
Revenue recognised according to percentage of completion	(1)	616
Depreciation of buildings	(3)	8,884
Finance leases	(3), (6)	- 4,519
Market value of securities and financial derivatives	(2), (4)	10,957
Deferred tax assets	(5)	38,060
Adjustments to other accruals	(8)	16,110
Adjustments of pension accrual	(9)	- 10,653
Deferred tax liabilities	(5)	- 14,994
<b>Equity in accordance with IFRS at 01.01.2003</b>		<b>258,929</b>

## Reconciliation of the Balance Sheet from HGB to IFRS at December 31, 2003

## Assets

€ thousands		HGB	Income Statement/ Equity	Reclassifications	IFRS
	Note	31.12.2003	related changes		31.12.2003
<b>A. Current Assets</b>					
Cash on hand and bank balances		53,083	0	0	53,083
Securities		21,076	0	0	21,076
Inventories	(1)	1,809	0	- 1,422	387
Trade receivables	(1)	106,730	841	1,422	108,993
Other receivables and other assets	(4)	6,390	1,311	0	7,701
Deferred expenses		6,970	- 494	0	6,476
		<b>196,058</b>	<b>1,658</b>	<b>0</b>	<b>197,716</b>
<b>B. Non-current assets</b>					
Intangible assets		1,491	0	0	1,491
Goodwill	(2)	154,633	21,839	0	176,472
Property, plant and equipment	(3)	36,834	11,046	0	47,880
Financial assets	(4)	6,949	18,079	- 3,489	21,539
Trade receivables		15,585	0	0	15,585
Deferred taxes	(5)	33,848	11,111	0	44,959
		<b>249,340</b>	<b>62,075</b>	<b>- 3,489</b>	<b>307,926</b>
<b>Total assets</b>		<b>445,398</b>	<b>63,733</b>	<b>- 3,489</b>	<b>505,642</b>

<b>Equity and liabilities</b>					
€ thousands					
	Note	HGB 31. 12. 2003	Income Statement/ Equity related changes	Reclassifications	IFRS 31. 12. 2003
<b>A. Current liabilities</b>					
Current financial liabilities	(6)	3,876	2,670	0	6,546
Trade payables	(7)	17,934	0	8,836	26,770
Other current liabilities	(7)	15,482	0	9,812	25,294
Current provisions	(8)	99,184	- 4,635	- 28,404	66,145
Tax provisions		10,929	0	0	10,929
Deferred income		57,710	- 380	0	57,330
		<b>205,115</b>	<b>- 2,345</b>	<b>- 9,756</b>	<b>193,014</b>
<b>B. Non-current liabilities</b>					
Non-current financial liabilities	(6)	4,155	201	0	4,356
Trade payables		0	0	22	22
Other non-current liabilities	(7)	220	0	888	1,108
Provisions for pension	(9)	7,464	12,202	0	19,666
Non-current provisions	(7)	0	0	5,357	5,357
Deferred taxes	(5)	13	12,785	0	12,798
		<b>11,852</b>	<b>25,188</b>	<b>6,267</b>	<b>43,307</b>
<b>E. Equity</b>					
Share capital		81,800	0	0	81,800
Capital reserve		132	0	0	132
Retained earnings		155,563	11,948	- 18,153	149,358
Consolidated income		- 3,322	10,441	- 23	7,096
Currency translation differences	(10)	- 5,868	0	- 26,472	- 32,340
Other reserves	(11)	0	18,501	44,648	63,149
Minority interest		126	0	0	126
		<b>228,431</b>	<b>40,890</b>	<b>0</b>	<b>269,321</b>
<b>Total equity and liabilities</b>		<b>445,398</b>	<b>63,733</b>	<b>- 3,489</b>	<b>505,642</b>

**Comments to the reconciliation of the Balance Sheet from HGB to IFRS at December 31, 2003:**

- (1) Work in progress as defined by HGB was recognized and posted as non-invoiced receivables according to the percentage of completion method (including a portion of the margin).
- (2) Scheduled amortization of goodwill pursuant to HGB was reversed as, according to IFRS 1, where IFRS 3 is voluntarily applied to 2004, must be applied to 2003. Accordingly, 2003 goodwill was not amortized according to the straightline method.
- (3) Depreciation of property was adjusted to take account of expected useful economic life. Assets from capital leases were capitalized.
- (4) This change is a result of the fair-market valuation of securities. The change is included in other comprehensive income under equity, but not recognized in net profit or loss for the period. Derivative instruments are valued at fair market value, even where this exceeds the cost of acquisition.
- (5) Deferred tax assets are primarily formed for loss carryforwards and provisions. Deferred tax liabilities are primarily formed for deferred expense and property, plant and equipment.
- (6) Long and short-term financial liabilities include capitalized liabilities from capital leases.
- (7) Certain provisions under HGB were reclassified as short or long-term liabilities to comply with IFRS.
- (8) The adjustment of provisions (recognized in net profit or loss) primarily comprises dissolved provisions for expenses (maintenance, guarantees) and provisions where the probability of the obligation having to be settled is less than 50 percent (legal costs, contingent losses, general risks). Reclassifications comprise provisions which, according to IFRS, are to be posted as liabilities. See also note (7).
- (9) The increase in pension provisions is primarily a result of the requirement under IFRS to include indirect pension obligations at SAG UK. These were not previously included, in accordance with the option granted by Article 28 of the Introductory Act to the German Commercial Code (EGHGB).
- (10) All currency translation differences were posted since the changeover to IFRS accounting methods. As permitted by IFRS 1.22, the HGB figure was reset to zero for the IFRS statements on January 1, 2003.
- (11) Other reserves includes unrealized gains from the fair-market valuation of securities and differences from the translation of long-term intercompany cash positions in foreign currencies (i.e. not in euros).

**Reconciliation of the Equity from HGB to IFRS at December 31, 2003**

€ thousands	Note	
<b>Equity in accordance with HGB at 31. 12. 2003</b>		<b>228,431</b>
Revenue recognised according to percentage of completion	(1)	841
Correction to goodwill amortization	(2)	21,839
Depreciation of buildings	(3)	8,920
Finance leases	(3), (6)	- 745
Market value of securities and financial derivatives	(2), (4)	19,390
Deferred tax assets	(5)	11,111
Adjustments to other accruals	(8)	4,635
Adjustments to pension accrual	(9)	- 12,202
Deferred tax liabilities	(5)	- 12,785
Other		- 114
<b>Equity in accordance with IFRS at 31. 12. 2003</b>		<b>269,321</b>

**Reconciliation of Net income/loss from HGB to IFRS at December 31, 2003**

€ thousands	Note	
<b>Net loss in accordance with HGB at 31. 12. 2003</b>		<b>- 3,322</b>
Revenue recognised according to percentage of completion	(1)	225
Correction to goodwill amortization	(2)	21,839
Depreciation of buildings	(3)	36
Finance leases	(3), (6)	3,774
Market value of securities and financial derivatives	(4)	- 159
Deferred tax assets	(5)	- 4,345
Adjustments to other accruals	(8)	- 11,475
Adjustments to pension accrual	(9)	- 1,549
Deferred tax liabilities	(5)	2,209
Other		- 137
<b>Net gain in accordance with IFRS at 31. 12. 2003</b>		<b>7,096</b>

## Other disclosures

### Market risk and the use of derivatives

As a company with international operations, Software AG is active in a variety of currency zones and therefore subject to exchange rate risks. Management continuously monitors these risks. Financial derivatives are used according to internal guidelines in order to mitigate risks arising from changes in interest rates, exchange rates or the value of financial assets. Hedging transactions using derivatives are only entered into to cover existing risk positions or business events that are highly likely to materialize.

#### a) Interest rate risks

The Company has an exposure to fluctuations in interest rates. Since there are no loan liabilities, interest rate risks apply only to cash and cash equivalents held by the Group.

Changes in the market interest rate result in changes in interest income due to the focus on financial assets with short-term maturities and investments with minimal fluctuation in value. In order to lessen this dependency, interest rate derivatives, primarily forward rate agreements, are used on a limited basis. These are measured at market value; changes in value are recognized as profit or loss.

#### b) Exchange rate risks

Forward currency and currency option deals are entered into in order to hedge the risk of future fluctuations in exchange rates. For this purpose foreign currency receivables and payables are offset to the extent possible and only the remaining net position is hedged. Anticipated cash flows are also hedged according to internal guidelines.

Hedging transactions are measured at market value. They are reported in the balance sheet under other assets/current liabilities. Changes in market value of derivative financial instruments designed to hedge future foreign currency cash flows are reported under other reserves until such time as the underlying transaction has been recognized in income. The non-effective portion of a cash flow hedge as well as changes in value of hedging transactions that do not meet the requirements of hedge accounting are immediately included in net income for the current year.

#### c) Risks of changes in value

In line with Group policy, assets are controlled in such a manner in terms of maturity, interest type and rating, that no noteworthy fluctuations in value are expected in the Company's view.

#### d) Credit risk

Software AG is exposed to default risk if contracting parties fail to meet their obligations. All financial instruments are transacted with banks with excellent credit ratings. The default risk of our business partners is considered to be extremely low.

### Volume and measurement of derivative financial instruments

The tables below show the transaction volumes of financial derivatives as of December 31, 2004, and December 31, 2003. The market value of these financial instruments is based on the values made available by the respective banks and correspond to the replacement cost at the balance sheet date.

Effects on income/expense from the market valuation of financial instruments.

Volume and measurement of derivative financial instruments							
€ thousands	Currency	Transaction volume		Positive market value		Negative market value	
		2004	2003	2004	2003	2004	2003
Forward currency contracts	GBP	0	995	0	10	0	0
	USD	1,668	0	107	0	0	0
Currency options	GBP	0	2,132	0	0	0	7
	USD	0	9,466	0	516	0	0
Forward rate agreements	EUR	10,000	0	8	0	0	0

Financial instruments shown are for the purpose of hedging an asset or liability recorded (fair value hedges). Changes in value are recorded against income.

In addition, agreements to hedge anticipated transactions (cash flow hedges) exist. Changes in value of these financial instruments are reported under other reserves. Once the anticipated underlying transaction has been realized, the changes in value booked to other provisions are reclassified and taken to income.

### Effects on other reserves from the market valuation of financial instruments.

Financial instruments (Cash flow hedges)							
€ thousands	Currency	Transaction volume		Positive market value		Negative market value	
		2004	2003	2004	2003	2004	2003
Forward currency contracts	GBP	500	0	5	0	0	0
	USD	13,186	0	1,196	0	0	0
Currency options	GBP	0	0	0	0	0	0
	USD	0	6,915	0	543	0	0

Currency options consist exclusively of unstructured EURO call options, so-called "plain vanilla options". Forward currency contracts include so-called "dynamic forward sales" in addition to traditional forward currency sales. In this case, Software AG has the opportunity of participating in positive market developments, but simultaneously has hedged at the defined "worst case" rate. This type of transaction showed a positive market value of €214 thousand at the balance sheet date, included in the table above.

A maximum default risk equivalent to the market values recorded arises from existing hedging transactions.

All financial instruments have a remaining term of less than a year.

Use of derivative financial instruments is purely to hedge existing or anticipated interest rate, currency or other market risks.

### Financial investment policy

Software AG is very conservative in its financial investments. Primarily time deposits and short-term fixed-interest securities, with a credit rating of at least "investment grade", are purchased. Interest on capital invested averaged approx. 2.1 percent in fiscal 2004.

### Legal proceedings

The following litigation is pending:

1.) Israeli software company./Software AG  
Software AG took over global product distribution for an Israeli software company in 1988. The relevant sales agreement lapsed in 1991. The parties negotiated a successor agreement for a considerable period of time, but the agreement did not come to fruition. Product distribution was continued during this period under mutual agreement until such time as the business relationship was definitively terminated in 1996.

After the business relationship was terminated, the Israeli company asserted claims for subsequent payment of license fees and damages resulting from the failure to complete a successor agreement and the allegedly improper termination of the business relationship. The plaintiff brought the legal case before the International Court of Arbitration and sued for millions. The legal dispute was amicably settled in January of 2005. The amount to be paid in settlement is fully disclosed in the 2004 financial statements.

2.) U.S. software company./Software AG Inc.  
In the middle of 2002, a U.S. software company sued Software AG Inc. before the U.S. District Court in Orlando for unspecified damages and negligence due to alleged patent violation by a Software AG product. The proceedings were amicably settled in December of 2004. Software AG Inc. agreed to pay the U.S. software company a settlement amount that is fully disclosed in the 2004 financial statements.

3.) Software AG Inc. and Software AG./additional U.S. software company  
Following the failure of out-of-court discussions, Software AG Inc. and Software AG sued a U.S. software company in July of 2003 for damages and negligence due to violation of a patent granted to Software AG in 1994. The proceedings are currently before the U.S. District Court in Delaware. Upon completion of the pre-trial discovery the court has set May 2005 for oral proceedings. In November of 2004 the company being sued has in turn instigated legal proceedings due to alleged patent violation before the U.S. District Court in Alexandria. The case is currently in pre-trial discovery.

### Operating leases

Rental or operating leases in the Group primarily relate to office space, vehicles and IT equipment. Lease payments from operating leases are recorded as expense over the term of the lease.

€ thousands	Within 1 year	1 to 5 years	> 5 years	Total
Lease payments	17,332	27,729	15,462	60,523
Expected income from sub-leases	2,115	1,434	68	3,617

### Contingent liabilities

No provisions have been created for the contingent liabilities below, expressed at nominal value, since claims in this regard are considered unlikely:

€ thousands	
Guarantees	4,361
Other	930
	5,291

### Seasonal influences

Revenues and pre-tax income were distributed as follows for fiscal 2004:

	1. Quarter 2004	2. Quarter 2004	3. Quarter 2004	4. Quarter 2004	2004
Revenue €	95,720	106,256	96,635	112,760	411,371
in % of annual sales	23.3	25.8	23.5	27.4	100.0
Earnings before taxes €	15,782	49,608	21,878	24,462	111,730
in % of net income for the year	14.1	44.4	19.6	21.9	100.0

A similar distribution of revenues throughout the year has been observed in prior years and is primarily the result of our customers' purchasing behavior. Restructuring measures in the first half of 2003 and in the first quarter of 2004 resulted in considerable cost savings and a corresponding rise in pre-tax earnings. €24,539 thousand in special income is included in earnings before taxes in the second quarter of 2004, arising from the sale of SAP-SI shares. It is not likely that similar special income will be achieved in future.

#### Comments on significant business events

Income from the sale of SAP-SI shares in the amount of €24,539 thousand was realized in the second quarter of 2004.

A total of €23,430 thousand was expended on restructuring measures during fiscal 2004. Provisions for restructuring had been created for this event in the amount of €30,682 thousand during the previous year.

#### Employees

The effective number of employees (i.e. part-time employees are taken into account on a pro-rated basis) can be broken down by qualification as follows:

	31.12.2004	31.12.2003
Applications development	954	929
Administration and other	536	552
Sales	310	293
Research and development	323	501
Customer service	154	145
Marketing	85	83
Executive and senior management	76	74
	2,438	2,577

The average absolute number of employees (i.e. part-time employees are recorded in full) in the Software AG Group in 2004 was 2,512 (previous year: 2,844).

As of the balance sheet date of December 31, 2004, an absolute number of 2,505 employees (previous year: 2,703) were engaged by the Group.

## Personnel expenses

Personnel expenses for fiscal 2004 and the previous year is composed as follows:

€ thousands	2004	2003
Salaries and wages	163,616	186,443
Social security	27,535	30,700
Expenses for pensions	5,195	5,837
	196,346	222,980

## Stock-based compensation

Software AG conducts different stock option plans for members of the Executive Board, key management staff and other Group employees; these have not been recorded as personnel expenses in the measurement process according to IFRS 2, due to the conditions for exercising the options.

### First Stock option plan:

145,846 subscription rights had been issued to members of the Executive Board and 69,069 subscription rights to key management staff as of the balance sheet date; however, these could not be exercised until after the balance sheet date. The number of subscription rights has thus remained unchanged since December 31, 2003. No subscription rights were exercised in the period under review. Options have a term of seven years dated from the time they are granted. They may only be exercised during their term, starting with a 24-month waiting period after the Company's IPO, on a quarterly basis, after the publication of annual results, half-year results and quarterly results.

The subscription price per share when exercising an option is equivalent to the issue price minus a discount of 20 percent, but must be at least €28.12 (DM 55.00). The minimum price was applied, since the issue price was €30.

In order for the options to be exercised, the following prerequisites must be satisfied:

- (1) The Group's profit from ordinary activities according to the German Commercial Code must have risen by a total of 30 percent in the years 1997 to 1999. This condition was met by the profits recorded at the time.
- (2) The Group's profit from ordinary activities is equivalent to at least 10 percent of sales in the year prior to exercise of the option.
- (3) The share price is above the minimum price at the time the option is exercised.

**Second Stock option plan:**

163,375 subscription rights had been issued to members of the Executive Board and 566,025 subscription rights to key management staff as of the balance sheet date; however, these could not be exercised until after the balance sheet date.

The subscription price per share in exercising an option is equivalent to the average of the XETRA closing prices over the last five trading days at the Frankfurt Stock Exchange prior to the offer to grant subscription rights.

In order for the options to be exercised, the following prerequisites must be satisfied:

- (1) The Group's sales must have risen at least 10 percent over the previous year's sales in the fiscal year preceding exercise of the options.
- (2) The Group's profit from ordinary activities is equivalent to at least 10 percent of sales in the year prior to exercise of the option.

Terms, waiting periods and exercise intervals correspond to conditions under the First Stock Option Plan.

**Remuneration of Executive Board and Supervisory Board**

Starting in fiscal 2005, remuneration of the Executive Board is being restructured and will be even more closely related to corporate profits.

Beginning on January 1, 2005, two-thirds of the compensation will be directly linked to revenue, earnings and other Company targets.

A portion of variable remuneration (30 percent) will only be paid in subsequent years based on a phantom share program. The stock option plan in effect previously will not be continued.

Remuneration of former Executive Board members totaled €2,103 thousand.

Pension provisions for departed members of the Executive Board amount to €2,676 thousand.

Remuneration of active Executive Board members for fiscal 2004 is composed as follows:

€	Fixed remuneration	Variable remuneration	Other remuneration components	Total	Stock options granted
Karl-Heinz Streibich Chairman of the Executive Board	444,000.00	772,025.47	39,018.47	1,255,043.94	20,000
Mark Edwards	252,173.93	603,307.36	28,250.67	883,731.96	17,500
Arnd Zinnhardt	270,600.00	446,648.82	21,614.84	738,863.66	0
Christian Barrios Marchant	252,000.00	293,070.88	13,029.92	558,100.80	8,750
Andreas Zeitler	306,775.00	221,105.27	22,216.13	550,096.40	20,000
Departed Executive Board members	317,027.23	109,237.45	32,551.72	458,816.40	0
<b>Total</b>	<b>1,842,576.16</b>	<b>2,445,395.25</b>	<b>156,681.75</b>	<b>4,444,653.16</b>	<b>66,250</b>

There was a variable salary prepayment to the Executive Board members in fiscal 2004 in

the amount of €493 thousand. Interest was not be charged.

Remuneration of Supervisory Board members for fiscal 2004 is composed as follows:

in EUR	Fixed remuneration	Variable remuneration	Remuneration for committee activities	Total
Frank F. Beelitz Chairman	20,000.00	40,000.00	18,000.00	78,000.00
Karl Heinz Achinger Deputy Chairman	15,000.00	30,000.00	14,000.00	59,000.00
Justus Mische	10,000.00	20,000.00	12,000.00	42,000.00
Reinhard Springer	10,000.00	20,000.00	3,000.00	33,000.00
Dr. Andreas Berezcky	6,667.00	13,333.00	0.00	20,000.00
Monika Neumann	5,000.00	10,000.00	4,500.00	19,500.00
Departed members of the Supervisory Board	6,667.00	13,333.00	4,500.00	24,500.00
<b>Total</b>	<b>73,334.00</b>	<b>146,666.00</b>	<b>56,000.00</b>	<b>276,000.00</b>

#### Events after the balance sheet date

Further expenditures related to restructuring measures in the amount of €7,506 thousand should be expected for fiscal 2005; these were provided for in the balance sheet as of December 31, 2004.

Software AG has acquired the Israeli company Sabratec Ltd. in full based on an agreement dated February 3, 2005. The purchase price of €5,376 thousand is to be paid in February of 2005.

In January 2005, a settlement agreement was concluded with a U.S. software company with respect to litigation. This settlement will be effected by a payment in the first quarter of 2005, already provided for in the 2004 financial statements.

Fujitsu Limited and Software AG signed an agreement on February 28, 2005, to jointly develop, market and sell a Service Oriented Architecture offering.

Fujitsu and Software AG plan to exploit their complementary technology platforms and global R&D know-how to offer a technical process with integrated meta-data storage. This will allow users to curtail development time, improve productivity and provide the flexibility necessary to respond to changing business challenges. As part of this partnership, Fujitsu and Software AG intend to launch a joint product range on the market in the summer of 2005. Software AG already sells Interstage Business Process Manager, Fujitsu's business process management solution.

#### Declaration on the German Corporate Governance Code

The Company published its declaration of conformity with the German Corporate Governance Code on January 28, 2005, in accordance with section 161 of the German Stock Corporation Act.

#### Time of release of this publication

Software AG's Executive Board approved the consolidated financial statements on February 28, 2005.

### Members of the Supervisory Board:

#### Frank F. Beelitz

Chairman  
Independent investment banker  
(Beelitz & Cie., Frankfurt am Main)  
Resident of: Bad Homburg v.d.H.

Supervisory Board memberships:

- Member of the Supervisory Board  
Syntec Capital AG, Munich
- Member of the Supervisory Board  
Südwestbank AG, Stuttgart  
(since June 1, 2004)
- Member of the Board of Directors  
Eon Labs. Inc., New York, N.Y., U.S.A.

#### Karl Heinz Achinger

Graduate in Business  
Deputy Chairman  
Independent management consultant  
Resident of: Seefeld

Supervisory Board memberships:

- Chairman of the Supervisory Board  
Dosch & Amand Systems AG, Munich  
(until September 30, 2004)
- Chairman of the Supervisory Board  
Magix AG, Munich
- Chairman of the Supervisory Board  
Tiscon AG, Neu-Ulm
- Member of the Supervisory Board  
debitel AG, Stuttgart (until June 4, 2004)
- Member of the Supervisory Board  
Dosch & Amand Systems AG, Munich  
(since October 1, 2004)
- Member of the Supervisory Board  
RWE Systems AG, Dortmund
- Member of the Supervisory Board  
TDS Informationstechnologie AG,  
Neckarsulm (since May 28, 2004)

- Member of the Supervisory Board  
teleson AG, Munich
- Member of the Board  
Augeo Software B.V., Nijkerk/The Netherlands  
(until February 12, 2004)

#### Dr. Andreas Bereczky

(since April 30, 2004)  
Director of Production ZDF, Mainz  
Resident of: Eschweiler

Supervisory Board memberships: none

#### Karl-Heinz Hageni

Employee representative  
(until April 30,)  
Software AG employee in  
the division of training and consulting  
Resident of: Alsbach-Hähnlein

Supervisory Board memberships: none

#### Dr. Peter Lex

(until April 30, 2004)  
Attorney  
Law practice of Dr. Mohren+Partner, Munich  
Resident of: Munich

Supervisory Board memberships: none

#### Justus Mische

Graduate in business  
Resident of: Kelkheim/Ts.

Supervisory Board memberships:

- Chairman of Supervisory Board  
Altana AG, Bad Homburg v.d.H.
- Chairman of Supervisory Board  
B. Braun Melsungen AG, Melsungen
- Chairman of Supervisory Board  
Hoechst AG, Frankfurt am Main  
(until October 6, 2004)

**Monika Neumann**

Employee representative  
 (since June 28, 2004)  
 Employee of SAG Systemhaus GmbH  
 Chairman of the General Works Council  
 Resident of: Schliersee  
 Supervisory Board memberships: none

**Reinhard Springer**

Employee representative  
 Employee of Software AG in the  
 Global Information Services Department  
 Resident of: Fränkisch-Crumbach  
 Supervisory Board memberships: none

**Members of Executive Board:****Karl-Heinz Streibich**

Graduate engineer Communications engineering  
 Chairman of the Executive Board  
 Resident of: Radolfzell  
 Supervisory Board memberships: none

**Christian Barrios Marchant**

Executive MBA  
 Member of the Executive Board  
 Resident of: La Moraleja, Alcobendas,  
 Madrid, Spain  
 Supervisory Board memberships:  
 ■ Member of Board of Directors  
 Visual Century S.A., Barcelona, Spanien

**Mark Edwards**

Businessman  
 Managing Director  
 Resident of: Buckhurst Hill, Essex, UK  
 Supervisory Board memberships:  
 ■ Member of Board of Directors  
 (Company Secretary)  
 Claremont Consulting Ltd., London, UK

**Dr. Peter Mossack**

Physicist  
 (until July 23, 2004)  
 Managing Director  
 Resident of: Erzhausen  
 Supervisory Board memberships: none

**Gary Voight**

BBA (until September 10, 2004)  
 Managing Director  
 Resident of: Reston, VA, USA  
 Supervisory Board memberships: none

**Andreas Zeitler**

Businessman  
 Managing Director  
 Resident of: Kelkheim/Ts.  
 Supervisory Board memberships: none

**Arnd Zinnhardt**

Graduate in business  
 Managing Director  
 Resident of: Kelkheim/Ts.  
 Supervisory Board memberships: none

Darmstadt, February 28, 2005  
 Software AG

K.-H. Streibich                      C. Barrios Marchant

M. Edwards                              A. Zeitler

A. Zinnhardt